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SUBJECT: EL SALVADOR MICROFINANCE SECTOR 2007: MOVING TOWARDS REGULATION

¶1. SUMMARY. A recent visit to three leading micro-finance institutions shows a booming market serving a broad client base ranging from street vendors to medium enterprises. Microfinance organizations are also seeking to become regulated financial institutions, which will allow them to take deposits and finance their operations at lower rates. Despite some regulatory hurdles, the outlook for the sector looks positive, though increased competition may lead to future consolidation. END SUMMARY.

¶2. During a September 6-7 visit, Overseas Private Investment Corporation (OPIC) Senior International Economist Joseph Wozniak and Econoff visited ABANSA, El Salvador's private bank association, and three leading local microfinance institutions: Accovi, AMC, and Apoyo Integral. All three institutions have received support from OPIC through its relationship with Seattle-based Global Partnerships.

SECTOR OVERVIEW

¶3. El Salvador's regulated financial sector is divided into two categories of institutions: Banks and Non-Banking Financial Institutions (NBFI). While the laws governing both categories are largely the same, they differ in two key areas. First, NBFIs must meet a 15 percent reserve requirement, while banks must only maintain a 12 percent reserve. Second, while they may offer deposit (savings) accounts, NBFIs are not allowed to issue current (checking) accounts. Unregulated institutions, including most microfinance operations, may not hold deposits.

¶4. Unregulated institutions may become regulated through a formal process, which includes meeting the reserve requirement, upgrading information technology infrastructure, and meeting the Superintendent of the Financial System's reporting requirements. The process is both expensive and time-consuming, and few unregulated institutions have completed it. Accovi, AMC, and Apoyo have all received support from USAID's financial sector program to help become regulated institutions.

¶5. According to Carlos Caceres, Executive Director of ABANSA, the microfinance sector is dominated by two groups. Cajas de Creditos, which he described as private worker banks, are limited responsibility cooperatives which have been operating in the country for more than 70 years. They typically offer $500-1000 loans to their members. Non-governmental organizations (NGOs) offer a wider variety of loan services, but are not as established. NGOs also tend to support the very poorest segment of the market. In Caceres's view, the sector is so large that even with the large number of Cajas de Creditos and NGOs not everyone can get a microfinance loan.

¶6. ABANSA supports institutions becoming regulated in order to formalize what had previously been a largely informal sector.

Caceres stressed that formalized lending is far better than "the street," where loan sharks can charge exorbitant interest rates.

ACCOVI

¶7. Accovi, a San Vicente-based cooperative, has successfully become a regulated NBFI. General Director Nelson Alvarado stated that Accovi's financial indicators are actually better than most commercial banks, and they currently have a 22 percent reserve. Accovi's ten branches are concentrated primarily in the eastern and central regions. Accovi currently has 18,000 associates, who pay a $5 fee per month to the cooperative, and 33,000 non-member savings account holders. In addition to banking services, the associates also receive free doctor visits, discount pharmaceuticals, and educational opportunities (e.g., computer classes). Five percent of earnings is dedicated to these non-banking social services.

¶8. Accovi's minimum loan size is $50, and their average loan is $4,500. Their largest loan - a special client - is $250,000. Microfinance loans make up 7 percent of Accovi's portfolio, with a loan size of up to $600 and an average interest rate of 30 percent. Ninety percent of their loans are in the "small and medium category," with loans ranging from $600-20,000 and a typical interest rate of 12%.

¶9. Accovi offers three types of loans: consumer, enterprise, and housing. Thirty-seven percent of Accovi's total portfolio is housing loans, including both mortgages and home improvement. Mortgages require a 15% down payment with a 12% interest rate.

¶10. While still receiving some outside financing, Accovi now funds many of its loans through deposits. Alvarado complained that, as an NBFI, the Superintendent considers Accovi "more risky" than a bank,

even though Accovi is "more liquid than most commercial banks. " He would also like to see the laws changed to allow NBFIs to offer current accounts, so that Accovi could better compete with commercial banks while remaining a cooperative. Accovi's growth strategy is focused on small and medium enterprise loans, where they must compete directly with commercial banks.

AMC

¶11. San Miguel-based AMC (Adel Morazan Credito) is 90 percent owned by the Adel Morazan Foundation, a private development organization. According to Executive Director Wilson Salmeron, AMC has a special request pending to approve this single large shareholder before it can become regulated, but it hopes to complete the process by the end of 2007. AMC's current capitalization is $4 million and it offers points of service in 17 locations across the country.

¶12. AMC has over 13,000 outstanding loans, 11,900 of which are considered "micro," with an average loan size of $600. Micro loans go to individuals, families, or businesses with ten employees or less. Most micro loans are to individuals or businesses in the agriculture or services sectors or for housing. Housing loans may be as large as $10,000. Accovi's average interest rate is 28.5%, with a 34% rate on micro loans and a 16% rate on housing loans. The term varies with the type of loan. AMC has been averaging 40 percent growth per year and sees its greatest potential continuing to be the micro sector, even after regulation.

¶13. Thirty percent of AMC's clients receive remittances. Since it cannot capture deposits, AMC offers a "pass through" service on remittances, charging a $2 commission on up to $1,500. Remittances may be used as collateral for loans.

¶14. Salmeron sees two major benefits from regulation. First, AMC will be able to receive financing at a 5% interest rate, versus its current 9.5%. Second, AMC will be able to diversify its funding; Salmeron projects that 10 percent of future funding will come from deposits, and an additional 30 percent will come from other sources (Adel Morazan will retain a 60 percent stake).

APOYO INTEGRAL

¶15. Apoyo Integral was formed as part of the Fundacion Salvadorena de Apoyo Integral, a private development foundation. According to President Luis Castillo and General Director Carlos Viteri, Integral currently has a total capitalization of $7 million and 22 branches across the country. Sixty percent of its financing comes from international sources, while 40 percent is domestic. Both Integral and the foundation receive substantial support from the Duenas family, one of the wealthiest families in El Salvador. Integral hopes to become regulated by the end of 2007. The Superintendent is currently reviewing its systems and reports.

¶16. Integral's micro sector includes loans from $25-10,000 at interest rates from 15-45%. Integral divides the sector into three sub-sectors: survivor, simple accommodation, and expanding accommodation. Survivor loans (e.g., street vendors) are $25-100 loans with a 1-3 month tenor. Simple accommodation loans target businesses with less than 10 employees and sales of $20,000-$50,000 per year. Expanding accommodation loans target businesses with sales of $50,000-$70,000 per year. The average micro loan is $600-700.

¶17. Integral also lends to small enterprises (sales up to $700,000/year), but does not offer loans to medium enterprises. An average small enterprise loan is $18,000 at a 15% interest rate. Integral also offers loans up to $50,000 for housing, with a 15% down payment on mortgage loans.

¶18. Integral estimates that 30% of its clients receive remittances, which may be used as collateral. Castillo noted, however, that Integral is only processing about 3,000 remittance payments per month, and the trend is heading down. He attributed this in part to immigration issues in the U.S. and in part to current problems in the U.S. housing market.

¶19. According to Viteri, Integral has enjoyed 60% growth over the last year. Viteri views the urban market as oversaturated, and Integral's current strategy is focused on the rural and semi-rural markets, especially in the northern territories and the border regions. They also plan to offer insurance products and credit cards after regulation. They will continue to offer technical assistance to clients (especially those receiving housing loans) through the Foundation. Castillo sees two principal benefits from regulation. First, the institution gains credibility. Second, they

will be able to receive financing at lower interest rates.

COMMENT

¶20. All three institutions complained of regulatory headaches, seemingly arbitrary reporting requirements from the Superintendent, and high costs to become regulated institutions. All three, however, view the long-term benefits of regulation - deposits, credibility, and cheaper finance - as outweighing the short-term pain. While their growth projections look positive, increased competition, especially as international commercial banks enter the sector, and the challenge of maintaining efficient operations during expansion will likely lead to future consolidation within in the sector.

¶21. OPIC Joseph Wozniak has cleared this cable.

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